Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services	)	CC Docket No. 96-112

COMMENTS OF THE UNITED STATES TELEPHONE ASSOCIATION

United States Telephone Association
By Its Counsel:

Mary McDermott
Linda Kent
Charles D.Cosson
Keith Townsend

1401 H Street, N.W.
Suite 600
Washington, DC 20005
(202) 326-7247

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SUMMARY

USTA believes that new cost allocation rules are not needed to address the issues raised in this proceeding. Indeed, in the case of price cap regulated companies not subject to sharing, Part 64 itself is not necessary. A strength of Part 64 is that it does not impose a single, simple formulaic answer on complex issues Particularly when dealing with the regulatory allocations of joint and common costs, the allocations will inherently be arbitrary. The decisions made in this docket may significantly influence the LECs' decisions to deploy advanced broadband networks capable of supporting both regulated and nonregulated services.

"One size fits all" solutions to the cost allocation issue are inappropriate. USTA's members have widely divergent networks, incorporating different technologies, and serving disparate markets. Moreover, USTA's members can be expected to enter the video marketplace, and other unregulated markets through significantly different means, using different technologies and architectures, and at different rates of deployment. USTA's members can also be expected to continue to provide different types and amounts of "regulated" broadband services (including video-conferencing and video-telephony).

Under these circumstances, mandating a single cost allocation methodology utilizing a single set of fixed allocation factors for all LECs to separate out the joint and common costs is unlikely to lead to a cost-causative or an otherwise fair allocation of costs between regulated and unregulated activities, except by chance. A much better procedure would be to continue to use the present Part 64 approach, whereby each carrier would file or maintain a cost allocation manual that would specify the appropriate cost allocation procedures and factors the carrier would use to separate out the costs of video services.

For price cap regulated companies under the no sharing option, even current Part 64 requirements are not needed. Moreover, no adjustment to price cap indices to account for Exogenous changes is necessary, since, among other things, each affected LEC can propose appropriate treatment of the joint costs in its cost allocation manual. For rate-of-return regulated carriers, there is no need to develop new detailed cost allocation rules, such as cost pools and allocation factors, or new expense allocation rules. With respect to spare capacity, current cost allocation practices properly reflect the costs of this plant associated with providing common carrier services, including future high speed services. USTA also opposes the establishment of a cost allocation ceiling for loop costs, which would be contrary to the goals of the Telecommunications Act of 1996.

New cost allocation rules are unnecessary for USTA's members to help attain the relevant goals of the Telecom Act of 1996. Congress has indicated a preference for competition in the local telephone and video programming marketplaces, and the telephone companies' ability to provide full and fair competition is dependent on costing signals that are undistorted. The Commission should avoid the imposition of complex, costly, and unnecessary new regulatory burdens.

TABLE OF CONTENTS

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I. INTRODUCTION

The United States Telephone Association ("USTA") respectfully submits these comments in response to the Commission's *Notice of Proposed Rulemaking* in the above-captioned docket.[1] USTA is the principal trade association of the local exchange carrier ("LEC") industry, with over 1,000 members.

As a result of their experience and expertise, the LECs are poised to add significant competition to the communications marketplace for unregulated and regulated services. The results of this proceeding are critical to ensuring that LEC participation in this market is rapid,

[1] *Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services*, CC Docket No. 96-112, FCC No. 96-214, released May 10, 1996 (hereafter "*Notice*").

full and fair, thereby providing the benefits to the public that increased competition and innovation can bring.

USTA believes that new cost allocation rules are not needed to address the issues raised in the *Notice*. Indeed, in the case of price cap regulated companies not subject to sharing, Part 64 itself is not necessary. A strength of Part 64 is that it does not impose a single, simple formulaic answer on complex issues. Particularly when dealing with the regulatory allocations of joint and common costs, the allocations will inherently be arbitrary.[2/] Economists and accountants generally recognize that while there are "outer bounds" on the cost allocations,[3/] the specific requirements imposed by the regulators within those bounds involve fundamental policy determinations.[4/] The decisions made here may significantly influence the LECs' decisions to deploy advanced broadband networks capable of supporting both regulated and nonregulated services.[5/]

"One size fits all" solutions to the cost allocation issue are wholly inappropriate. USTA's members have widely divergent networks, incorporating different technologies, and serving disparate markets. Moreover, USTA's members can be expected to enter the video

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2/ USTA believes it is more appropriate to view these allocation decisions as inherently arbitrary, rather than "inevitably imperfect" as postulated in the *Notice* at ¶ 23.

3/ See e.g., *Notice* at ¶ 20.

4/ In an affidavit attached to these Comments, J. Gregory Sidak, a Fellow in Law and Economics at the American Enterprise Institute for Public Policy Research, discusses the policy factors relevant to the Commission's consideration of cost allocation issues (the "*Sidak Affidavit*").

5/ The Commission should thus be guided by the fundamental medical command of "first, do no harm."

marketplace and other unregulated markets through significantly different means, using different technologies and architectures, and at different rates of deployment. USTA's members can also be expected to continue to provide different types and amounts of "regulated" broadband services (including video-conferencing and video-telephony).

Under these circumstances, mandating a cost allocation methodology utilizing a single set of fixed allocation factors for all LECs to separate out the joint and common costs is unlikely to lead to a cost-causative or an otherwise fair allocation of costs between regulated and unregulated activities, except by happenstance. USTA believes that a much better procedure would be to continue to use the present Part 64 approach, whereby each carrier would file or maintain a cost allocation manual that would specify the appropriate cost allocation procedures and factors the carrier would use to separate out the costs of video services.[6/] However, for price cap regulated companies under the no sharing option, even current Part 64 requirements are not needed.[7/]

New cost allocation rules are unnecessary for USTA's members to help attain the relevant goals in the Telecommunications Act of 1996 ("Telecom Act of 1996"). Congress has indicated a preference for competition in the local telephone and video programming marketplaces,[8/] and the telephone companies' ability to provide full and fair competition is dependent on costing signals that are undistorted. Congress has also expressed a desire to

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6/ Filed manuals would be subject to public comment and Commission review, and the other safeguards (such as annual independent audits) would continue to apply. See, e.g., 47 CFR § 64.903.

7/ See *Sidak Affidavit*, Section II.

8/ See e.g., 47 U.S.C. §§ 251-253, 521(6) and 571.

ensure the availability of advanced telecommunications services to schools and hospitals,[9] a goal which will be supported by the robust, advanced networks contemplated for joint operations. Finally, the Commission should avoid the imposition of complex, costly, and unnecessary new regulatory burdens. This is consistent with Section 10 of the Telecom Act of 1996, whereby Congress gave the Commission authority to forebear from any unnecessary or counterproductive regulation.

II. THE COMMISSION NEED NOT DEVELOP EXPLICIT DETAILED COST ALLOCATION RULES FOR PRICE CAP REGULATED CARRIERS

A. The Price Cap Rules Already Guard Against Cost Shifting

The Commission's primary concern in the *Notice* is with the potential for misallocations of costs between the regulated and nonregulated activities of the LECs. According to the *Notice*, such cost-shifting could have the effect of allowing a telephone company to cross-subsidize its competitive video programming services with revenues from its "captive" ratepayers.[10] With respect to the incumbent LECs regulated under price caps, however, such fears are unfounded.

Under price cap regulation, the carrier has no incentives to shift costs into the regulated accounts, because the carrier will still be constrained by the price caps from increasing the rates it charges its regulated services customers.[11] Any misallocation of costs

9/ See e.g., 47 U.S.C. § 254(h).

10/ *Notice* at ¶ 22.

11/ See generally *Sidak Affidavit*, Sections II, III.

will have no adverse impact on telephony ratepayers.[12] Prescribing detailed and/or arbitrary cost allocation requirements for price cap carriers will afford no greater protection to ratepayers, but it will impose significant costs on the telephone companies in the form of added accounting burdens and additional reporting and compliance costs.[13]

Indeed, USTA believes that the imposition of unnecessary regulations, including cost allocation rules, is inconsistent with Section 10 of the Telecom Act of 1996. Under that provision, the Commission is directed to eliminate regulation unless it is necessary to ensure that rates are just and reasonable, necessary to protect consumers, and consistent with the public interest. For carriers subject to price cap regulation, these criteria are not met. The price cap formula will ensure that prices do not exceed the stand alone costs for providing the regulated services, thus ensuring that rates remain just and reasonable. Likewise, the price cap ceilings will adequately protect the interest of telephony ratepayers. In addition, the

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12/ *Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates*, CC Docket No. 93-251, FCC 93-453, released October 20, 1993 at ¶ 101; *Computer III Remand Proceedings*, 6 FCC Rcd 7571 (1991) at ¶ 13. Indeed, as competition increases, the concept of "captive" telephony ratepayers becomes increasingly invalid. See *Sidak Affidavit*, Sections III, IV.

13/ The costs of a telephone company complying with Part 64 requirements will typically exceed several million dollars annually for each company. In addition, the Commission will incur costs in monitoring and reviewing the related filings. While theoretically a price cap carrier subject to a sharing constraint has some incentives to engage in cost-shifting so as to eliminate any sharing obligation, USTA believes that those incentives are minimal. Indeed, to the extent that the price caps already set the upper bound of the appropriate charges to the ratepayers (as the surrogate for stand-alone costs), the ratepayers are still no worse off under the joint operations (even assuming *arguendo* cost-shifting occurs). The price cap constraints would effectively preclude the LEC from increasing its rates above the stand-alone costs, regardless of any misallocations of costs. Thus, USTA does not believe that the added expenses and burdens from imposing detailed cost allocation requirements on price cap carriers (even when subject to sharing constraints) are necessary or economically sound.

imposition of unnecessary burdens on the carriers is contrary to the public interest. Moreover, to the extent that the Commission adopts rules that overallocate costs to unregulated activities, the Commission can create artificial disincentives to the deployment of new technologies. Doing so would discourage the rapid and efficient implementation of a broadband network that will benefit both the regulated and unregulated services customers. Thus, for price cap carriers that have elected the no sharing option, the Commission should forebear from imposing any Part 64 requirements.

B. To the Extent There Is a Perceived Need for Continued Oversight of Shared Costs, Each Carrier Should Develop Treatment Appropriate for it in Its CAM

In the *Notice*, the Commission seeks to reexamine its Part 64 rules regarding the use of forward looking, usage based allocators for shared network investments. USTA believes that critical to any cost allocation framework is the precept that allocators be based on attributes that are (a) measurable; and (b) common among the categories to which the cost is being allocated. The Commission correctly notes that the usage characteristics of video (and possibly other broadband services) differ significantly from those of traditional regulated telephony services.[14] Furthermore, as additional new services are developed, it is quite possible that these new services may not share common usage characteristics with either current video or telephony offerings.

Even if Part 64 rules are still considered necessary in a price cap environment, the rules for network plant investment, as they currently stand, could yield flawed results. USTA

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[14] See e.g., *Notice* at ¶¶ 30-31.

agrees with the Commission's conclusion that continued use of forecasted usage to allocate shared network investment may produce results inconsistent with the goals of the Telecom Act of 1996, this proceeding, and the Part 64 rules. Such forecasts are cumbersome to perform and, in today's rapidly changing telecommunications environment, increasingly unreliable indicators of future conditions.

Although the Commission appropriately recognizes the need to revisit the basis for shared network investment allocators, it nevertheless seems to ignore the goals of the Telecom Act of 1996 (and its own experience) when it suggests that it should prescribe specific cost pools and allocation factors. Prescribing specific cost pools and allocation factors imposes intrusive regulation in contradiction to Congress' intent in the Telecom Act of 1996, and ignores the fact that carriers will be offering varying mixes of services utilizing different types of technologies and platforms. In this increasingly competitive and divergent environment, where both customers and providers have numerous choices, clearly "one size" does not fit all.

The Commission's goal of simplicity and uniformity is a laudable one. However, accuracy should not be sacrificed solely to achieve simplicity and uniformity. Time and again, the Commission has found that the differences in carriers' mix of services and the manner in which services are engineered or provided simply do not allow for absolute uniformity.[15/] Nothing associated with the provision of video or other broadband services warrants a change to these conclusions.

15/ See *Computer III Remand Proceedings*, 6 FCC Rcd 7571 (1991) at n. 46; *Separation of Costs of Telephone Service from Costs of Nonregulated Activities*, 2 FCC Rcd 1298 (1987) at n. 225.

USTA urges the Commission not to prescribe detailed allocation rules, but instead to set general guidelines for framework to ensure that the goals of the Telecom Act of 1996 are met. Under this approach, the carriers would be allowed to develop cost pools and allocators (incorporated in their cost allocation manuals ("CAMs")) which accurately reflect their individual business plans. Although a uniform fixed factor may present a solution with a certain simplistic elegance, a single fixed factor would not provide appropriate results for all LECs. Furthermore, at the present time, there are no bases, experience or facts upon which to set a single fixed factor to apply to all carriers, particularly in light of the vast differences in the current (and planned) technologies and services deployed by each carrier. Thus, at least for the near future, USTA urges the Commission to allow each carrier to evaluate its own plans, and develop appropriate cost pools and allocators (including fixed factors, if appropriate) based on general guidelines and principles of cost causation.[16/]

USTA believes that such an approach comports fully with Congress' goals in enacting the Telecom Act of 1996. As a threshold matter, USTA observes that Congress was aware of the Commission's efforts to promulgate rules to cover the provision of video dialtone ("VDT") service by telecommunications carriers.[17/] Moreover, Congress was aware of the requirement

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[16/] Moreover, to the extent that the Commission prescribes any new allocation factors, it should do so only with respect to new investment. Thus, any new cost allocation prescriptions would not govern *shifting* costs from regulated to unregulated accounts, but instead would merely govern how *newly incurred* investments will be allocated as between regulated and unregulated accounts.

[17/] After several years of proceedings, the Commission in 1994 issued an order adopting guidelines for identification of VDT costs and delegated to the Common Carrier Bureau the authority to issue appropriate guidance, including Responsible Accounting Officer ("RAO") letters, regarding the accounting records required by these rules. The Bureau issued (continued...)

that carriers obtain a certificate under Section 214 before constructing or operating a system for delivery of video programming.

Congress responded to these specific issues by enacting legislation that repealed the telephone-cable cross-ownership restriction. Congress also added a new Section 651(c), which eliminated the requirement that common carriers obtain a certificate under Section 214 to establish or operate a system for delivery of video programming. Equally important regarding Congress' intent is the fact that Section 302(b)(3) effectively terminated the VDT regulations and policies promulgated by the Commission in CC Docket No. 87-266 (i.e., RAO 25 and Reporting Requirements), but did not require termination of any VDT system approved before enactment of the Telecom Act of 1996. Moreover, the Telecom Act of 1996 specifically excludes open video systems ("OVS") from regulation under Title II, and additionally establishes a scheme for reduced regulation of OVS under Title VI. Finally, Section 10 of the Telecom Act of 1996 directs the Commission to forbear from regulation whenever appropriate.

It is clear from the foregoing that Congress intended to create a level playing field for incumbent carriers and competitors. It is equally clear that the Commission's continued emphasis on detailed cost allocation for the LECs suggested in this *Notice* unnecessarily

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(...continued)
RAO Letter 25, which prescribed the accounting records carriers would be required to maintain for VDT costs. In 1995, the Commission issued its order promulgating reporting requirements for VDT. Carriers were required by that Order to report VDT costs as regulated and nonregulated costs and by interstate/state jurisdiction. Carriers' requests for reconsideration of the record keeping requirements in RAO 25 and the reporting requirements in the Commission's order were pending at the time Congress approved the Telecom Act of 1996.

reincarnates, to a large extent, the regulatory burdens imposed by its VDT rules that were removed pursuant to the Telecom Act of 1996.

The Commission's proposal would readopt these earlier rules by modifying the Part 64 cost allocation rules to create arbitrary allocations of fixed investment and related costs. This proposal to modify the Part 64 rules and arbitrarily assign costs of stand-alone telecommunications systems of incumbent local exchange carriers to OVS is unnecessary to protect telephony customers from cross-subsidizing video programming or other nonregulated services. The Commission's proposal to engage in prescribing detailed cost allocations appears to be based on the notion that the rates charged for the current stand-alone telecommunications systems are unreasonable, or that joint use of the network will lead to unreasonable rates in the future. For either assumption to be valid, it would be necessary to conclude that the current network is inefficient, that the Commission's current price cap and Part 64 rules are ineffective, and that existing telecommunications services will have no competition in the future. USTA believes that all of these premises are inaccurate.

Moreover, the Commission's stated intent to assign a significant portion of joint use investment and common costs to unregulated activities creates economic disincentives that discourage joint use of the existing capacity required to provide both nonregulated activities and regulated telecommunications services. Such a policy creates uncertainty and increases the incentive for incumbent local exchange carriers to construct separate facilities for the provision of unregulated activities.

The LECs currently face significant competition in their territories, and that competition is expected to grow significantly as a result of the changes wrought by the

Telecom Act of 1996.[18] That increased competition will come from the competitive local exchange carriers, wireless services providers, interexchange carriers and cable TV companies that have already begun to provide significant amounts of local exchange telecommunications services. In addition, electric utilities have constructed significant fiber capacity and are either considering providing local exchange service, or leasing this capacity to others interested in providing local exchange services, OVS, and other advanced telecommunications, voice, data and video services.

The Commission, however, is not proposing regulatory parity among all of these different competitors. Rather, the Commission proposes only to impose detailed changes to its already complex Part 64 Rules on the incumbent LECs. USTA contends that these additional regulatory obstacles applied only to the incumbent LECs will thwart the stated goal of the Telecom Act of 1996:

> [T]o provide for pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition.

USTA believes the Commission should recognize that it cannot achieve these goals unless it abandons its continued reliance on arbitrary, detailed cost allocation rules. The Commission should acknowledge that such rules create disincentives to use investment jointly to provide service, thereby depriving both regulated customers and video program customers of the manifold benefits of a robust, broadband network. The pro-competitive, deregulated

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[18] See, e.g., John J. Keller, *AT&T Discounts Signal a National Price War*, Wall St. Journal (May 30, 1996) at B1.

national policy framework envisioned by Congress will ultimately be achieved only by eliminating (or at least streamlining) the Part 64 Rules. The suggested expansion of these rules further hampers achievement of this goal

C. No Adjustment to Price Cap Indices to Account for Exogenous Changes Is Necessary in This Case

USTA also disagrees with the notion that the Commission should adjust the price cap carriers' indices to reflect the "exogenous" impact of cost reallocations being proposed in this proceeding. The goal of the Telecom Act of 1996 is to provide for a procompetitive, deregulatory environment to accelerate competition in all communications markets, including both regulated and nonregulated activities of the LECs. A competitive environment is best served by market-based rates. The Commission has previously recognized that progress toward market-based rates will be impeded if exogenous cost adjustments continue to be allowed.[19/]

The *Notice* raises the question of whether the existing price cap rule, which treats as an exogenous adjustment "the reallocation of investment from regulated to nonregulated," should apply to all allocations that would result from video programming, and whether this should force a decrease in regulated prices.[20/] USTA believes that imposing such a requirement in this proceeding would be inconsistent with the Telecom Act of 1996 and inconsistent with the rationale underlying the original Part 64 exogenous change requirements.

19/ *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8961 (1995) at ¶ 299.

20/ *Notice* at ¶ 60.

1. Introducing a New Exogenous Change Item Would Be Inconsistent With the Act

Introducing a new exogenous change item, as the *Notice* suggests, conflicts with the Telecom Act's objectives to foster competition and achieve a reduction in regulated prices through competition. The Commission has recognized that an overallocation of common costs to nonregulated activities could dissuade the LECs from entering nonregulated competitive markets, thus depriving regulated ratepayers of any benefit from the potential economies of scope derived from using facilities to provide both services.[21] LECs will also be dissuaded from entering nonregulated competitive markets if the Commission establishes rules that will adjust regulated prices downward twice for entering into the video or other nonregulated businesses. The moving average Total Factor Productivity ("TFP") methodology, which the Commission tentatively concluded should be adopted for its long-term price cap regulation, reflects the economies of scale achieved through the provisioning of regulated and nonregulated services over a shared system.[22] Requiring an exogenous reduction for the same economies of scale already included in the TFP, as the *Notice* proposes through the reallocation of costs from regulated to nonregulated, would result in a double reduction.

A double reduction would conflict with the Commission's purpose in adopting exogenous cost rules "to ensure that the price cap formula does not lead to unreasonably high

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21/ *Notice* at ¶ 20.

22/ *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8961 (1995) at ¶ 159.

or unreasonably low rates."[23] A double reduction for the same economies of scale would cause rates to be unreasonably low.

2. Intent Of The Current Price Cap Part 64 Exogenous Adjustment

The reallocation from regulated to nonregulated accounts referenced in the price cap rules was developed as a measure to deter carriers from intentionally underforecasting the nonregulated operations' use of joint and common facilities.[24] If the nonregulated forecast is too low, the regulated rate base is overstated. The exogenous treatment was to be applied to compensate the ratepayer for the misallocation into the rate base of shared network investment resulting from an underforecasted allocation factor. This adjustment was never intended to address sharing (through prescribed allocation factors) of the economies of scope from joint operations as the *Notice* is now proposing.[25] The Commission should not attempt to make such an adjustment under the guise of an "exogenous change."

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[23] Id. at ¶ 294.

[24] Under Part 64, the carriers are directed to use a forecast allocator, rather than an actual or historic allocator, to separate shared Central Office and Outside Plant investment.

[25] *Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, 3 FCC Rcd 6701 (1988) at ¶ 34.

3. Each Carrier Can Propose Appropriate Treatment of the Joint Costs in Its CAM

As indicated above. USTA believes that there is no need for the Commission to prescribe detailed cost allocations under Part 64 for price cap regulated carriers. Under price caps, carriers have no incentive to shift costs, and the price cap indices already preclude carriers from charging more than the stand-alone costs for the "captive" ratepayers. Accordingly, Part 64 cost allocation requirements should not apply to these carriers. To the extent the Commission continues to apply any Part 64 requirements, each telephone company can propose in its CAM a cost allocation methodology to account for shared costs, and that accounting treatment can specify (in lieu of detailed Commission prescription of exogenous cost adjustments) the appropriate treatment of the joint and common costs.

III. THE COMMISSION NEED NOT DEVELOP DETAILED COST ALLOCATION RULES FOR RATE-OF-RETURN REGULATED CARRIERS

USTA also believes that the Commission's proposal to prescribe detailed, "one size fits all" cost allocation rules with respect to rate-of-return regulated LECs is a solution in search of a problem. Many of these carriers have been operating under the current Part 64 requirements for several years (including providing video programming services under the rural exemption to the cross-ownership ban). and USTA is not aware of any allegations that those rules have not worked effectively to protect ratepayers and competition.

Particularly for the smaller, rate-of-return regulated LECs, costs should be allocated based on known facts and the current operating conditions of each company, and not on assumptions of future events. Current technological change is quickly making any assumptions or guesses as to the future of the networks invalid.[26] The accurate allocation of costs will support the just and reasonable rates paid by all subscribers, and also provide the means to maintain and upgrade the carriers' facilities (to the benefit of regulated and nonregulated services customers) as demanded by the common carrier marketplace.

USTA believes that for rate-of-return LECs, the allocations should be flexible and subject to general guidelines rather than detailed and rigid rules. These guidelines must allow individual LECs to be responsive to their own set of market conditions and technology deployment. The Rules should permit carriers to adjust their mix of services without being restricted by a predetermined view of the marketplace And the Rules must allow carriers to keep pace with technological evolution. If the Commission adopts the proposed inflexible rules, it will be hampering the development of competition in contravention of the intent of the Telecom Act of 1996.

The general guidelines must address both regulated and nonregulated services in toto, and not on a service-by-service basis, in recognition of the fact that cost allocation of jointly shared plant is inherently imprecise. Requiring allocations to be performed on a service-by-service basis would likely increase the level of error, thus forcing overallocations to either the ratepayer or to the nonregulated services. Both types of errors are onerous. To minimize such error, the required cost allocations should continue to be made at a total regulated/nonregulated service level.

Many small companies do not base their rates on their actual costs, but instead participate in average schedule tariffs maintained by the National Exchange Carrier

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[26] See generally *Sidak Affidavit*, Sections III, IV.

Association (NECA) and annually reviewed by the Commission.[27] These LECs recover costs through average schedule formulas developed by NECA that include such variables as access lines, access minutes, and other items of demand. Direct costs are not submitted because of the recognized burden that would be imposed on these companies if they were to complete the necessary and detailed underlying studies. For these companies, as with price cap LECs, there is no incentive to shift costs because their access compensation does not come from their costs, but ratheir from an average schedule of rates set nationally. In short, they cannot cost-shift to affect the prices charged for their services. As of November, 1995, NECA has reported that there are 611 average schedule study areas serving a total of 2,449,457 access lines.[28]

A. Detailed Cost Pools and Allocation Factors Are Unnecessary

USTA opposes the notion of prescribing detailed cost pools and allocation factors for rate-of-return LECs. While such a methodology focuses on the concept of administrative simplicity and uniformity, it constrains the ability of such LECs to make basic economic choices as to how they should best deploy their resources. The Commission's proposal for detailed prescriptions in the rate-of-return setting is based on the mistaken notion that "one size fits all."

The present cost allocation rules, while not perfect, are best suited to meeting the policy goals of the *Notice*. The cost allocation rules codified in Part 64 were designed to be

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27/ See MTS and WATS Market Structure: Average Schedule Companies, Memorandum Opinion and Order, 6 FCC Rcd 6608 (1991).

28/ 1996 Modification of Average Schedules, Volume 1, Pg. I-2, fn. 6 (Submitted by NECA as attachment to letter to William F. Caton from James W. Frame, January 11, 1996).

sufficiently broad to encompass new types of products and services. These rules have protected telephony ratepayers in the past and will continue to do in the future. To change the rules now would impose unnecessary costs on rate-of-return LECs, which would have to change their well-established internal processes of accounting for their costs. Imposing these costs would not produce any benefits. Moreover, the magnitude of anticipated cost shifts will be negligible for rate-of-return LECs, since the present and the foreseeable makeup of this plant will remain regulated.

Allocations should be defined in the CAM of each rate-of-return LEC in terms of its unique current operating conditions. Otherwise, broad assumptions regarding the future will likely lead to unrealistic cost allocations. The Commission appears to assume that a nonregulated service like video programming will demand the greatest capacity from LECs' systems. Such an assumption does not give sufficient weight to the new technologies that will demand as much, or greater, capacity for regulated common carrier services. An example of an emerging high capacity regulated service could be the marriage of the high definition TV, the computer and the telephone. In the future, ratepayers routinely may be making video calls on a common carrier basis, instead of the voice grade calls the Commission apparently assumes will exist. It is possible that such video calls could be as prevalent tomorrow as voice grade calls are today. Such calls would require much higher capacity than any regulated calls now do. As a result, it is unclear whether the nonregulated services of the future will take as much relative capacity as the Commission anticipates The corresponding allocation factors must be allowed to evolve to reflect such developments

Rate-of-return regulated LECs must not be hampered or constrained by unrealistic regulations. To apply separate sets of regulations to competitors in the same marketplace essentially penalizes those competitors -- the LECs -- with the greatest regulatory burden. As it now stands, the rate-of-return LECs bear the greatest regulatory responsibility. If onerous cost allocation requirements are adopted, as competition increases, the rate-of-return LECs will not be able to respond effectively, thus denying the benefits of competition to their regulated and nonregulated customers. This result would be directly against the intent of the Telecom Act.

B. Expense Allocation

USTA supports the present allocation of network-related expenses based on network plant allocation, of indirectly attributed marketing expenses allocated based on the relationship between directly allocated marketing costs, and of overheads allocated based on a general allocator. To apply a different methodology to these costs would not fit the Commission's goals of administrative simplicity and consistency with cost-causation principles. To apply the cost-causation principles, maintenance costs should be allocated based on an indirect cost allocation method. In this case, the relative allocation factors of the maintained plant should be used.[29]

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[29] See *Notice* at ¶ 48.

IV. RESPONSES TO OTHER SPECIFIC PROPOSALS IN THE *NOTICE*

A. Existing Practice Regarding "Spare Capacity"

The Notice implies that, under current cost allocation rules, ratepayers for regulated services may inappropriately be paying for "spare" fiber capacity that LECs will ultimately use for unregulated services.[30] USTA wishes to correct any such misimpression. The "spare" capacity available on USTA members' networks merely reflects the technical properties of fiber optics, which possesses extremely high bandwidth. Current allocations properly reflect the costs of this plant associated with providing regulated services, including future high speed common carrier services.

"Spare capacity" is a normal part of engineering plant, needed to ensure that customers can be provided telephony in a timely manner. Indeed, LECs would have difficulty satisfying their common carrier service obligations without such capacity. Typically, when an area is initially engineered, rehabilitated or reengineered due to growth, the engineering is based upon current demand levels, plus approximately 3 to 5 years of growth in the feeder plant. Additional considerations, such as alternate route diversity, the availability of alternative providers, and sound engineering judgment, are factors in determining how much plant to place. All of these factors impact the engineering of the network, including the deployment of capacity to meet future needs.

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[30] See *Notice* at ¶¶ 52 and 53.

Special cost pools for "spare" outside plant facilities are not required for Part 64 allocation of costs.[31] The "spare capacity" should be assigned to the same cost pools as the rest of the deployed capacity. When equipment is classified as regulated, the equipment, including the equipment's "spares," will be assigned to regulated. When equipment is classified as nonregulated, the equipment, including the equipment's "spares," will be assigned to nonregulated. When equipment is classified as common (shared between regulated and nonregulated services), the equipment, including the equipment's "spares," will be assigned to common. Since the common equipment and the common equipment's related "spares" will be in the same cost pool, both will automatically be allocated in the same manner. Requiring additional cost pools and special allocation rules only for "spares" is administratively burdensome and not necessary to ensure that "spares" are appropriately allocated between regulated and nonregulated services.

B. Establishment of a Cost Allocation Ceiling for Loop Costs

The Commission proposes to establish a cap on total loop costs that can be allocated to regulated operations by placing a ceiling on these costs and annually adjusting that ceiling by the net of inflation and productivity,[32] much like the price caps baskets' costs are adjusted. The *Notice* additionally asks if such a loop cap proposal can be implemented on an exchange-

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[31] Indeed, under the Uniform System of Accounts ("USOA") there are not separate accounts for "spare capacity."

[32] See *Notice* at ¶ 35.